

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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In the Matter of)
)
Price Cap Performance Review for)
Local Exchange Carriers;)
Treatment of Video Dialtone)
Services Under Price Cap Regulation)

CC Docket No. 94-1

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COMMENTS OF
SOUTHWESTERN BELL TELEPHONE COMPANY

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Summary*

SWBT does not support the proposals in the Third FNPRM. If VDT service is subject to any price cap regulation, this regulation should be consistent with the proposals being made by the Commission in the other FNPRMs pending before the Commission in this docket and currently being debated in federal legislation. The Commission should await the outcome of the other FNPRMs instead of presuming a result contrary to their proposals. It would be counterproductive to adopt an interim approach that would be superseded shortly after implementation. In any event, SWBT opposes the exclusion of VDT costs and revenues from sharing, but if the Commission insists on such exclusion, the Commission should consider the following alternative to the Third FNPRM's proposals: Instead of the FNPRM's *de minimis* threshold and cost allocation proposals, until the Commission gains more experience with VDT and the other FNPRMs are finalized, the Commission should simply use the existing rules for excluding the costs of price cap excluded services for sharing calculations, *i.e.*, costs are assumed to equal revenues. In the alternative, in the event the Commission decides to adopt VDT-specific exclusion rules, SWBT recommends that, instead of using problematic mechanisms based on VDT gross investment or RAO 25 data to determine the *de minimis* threshold, the Commission should use a simpler measure of the relative size of the VDT system compared to the telephone system in a study area: the relative number of households passed by VDT compared to total households or working loops. Finally, instead of the two methods of allocating costs to the VDT price cap basket (once the *de minimis* threshold is reached) described in the Third FNPRM, SWBT urges the Commission to perform this allocation by direct assignment of the Part 36 interstate VDT costs, which should be readily identifiable from Part 32 and Part 36 records.

* All abbreviations used herein are referenced within the text.

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COMMENTS OF
SOUTHWESTERN BELL TELEPHONE COMPANY

Southwestern Bell Telephone Company (SWBT), by its attorneys, hereby submits its Comments on the Third Further Notice of Proposed Rulemaking (Third FNPRM)¹ in the above-referenced proceeding. Because the premises underlying the Third FNPRM are seriously flawed, SWBT does not believe the Commission should proceed with price cap regulation of video dialtone (VDT) service by adopting anything as a result of the Third FNPRM. However, on the assumption that the Commission will proceed, SWBT provides specific proposals to make the best of this burdensome regulatory framework.

In any event, as SWBT and others voiced in their previous comments, VDT service should not be subject to price cap regulation at all given the highly competitive video marketplace and the LEC's *de minimis* (or, in some cases, non-existent) presence in the market.

¹ In the Matter of Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1, Second Report and Order and Third Further Notice of Proposed Rulemaking, FCC 95-394 (released September 21, 1995) (Third FNPRM).

I. THE THIRD FNPRM ASSUMES A CONCLUSION CONTRARY TO OTHER FNPRMS CURRENTLY PENDING BEFORE THE COMMISSION.

In the Third FNPRM, the Commission is asking how it should establish rules for the allocation of costs to a VDT price cap basket. These questions are required given the Commission's decision in the companion Second Report and Order to "exclude video dialtone costs and revenues from the calculation of a LEC's earnings from other regulated interstate services for the purposes of sharing and low-end adjustment once video dialtone costs are no longer *de minimis*."² This conclusion is directly at odds with the Commission's tentative conclusion regarding the lack of need for sharing in the Second FNPRM³ and Fourth FNPRM⁴ in this same docket.

In the First Report and Order, the Commission determined

that the sharing and low-end adjustment mechanisms should be eliminated as part of our new permanent price cap plan selecting a higher X-Factor. Consistent with our tentative finding that our plan should have at least two X-Factor options, we tentatively conclude that at least one option should be a pure price cap plan, with no sharing or low-end adjustment mechanism, and at least one of the lower options should feature sharing and a low-end adjustment mechanism. If we ultimately adopt a price cap plan that incorporates a moving average X-Factor, the ongoing routine of updating of the X-Factor should provide reasonable rates to customers, including more complete flow-through of LEC

² Id. ¶ 35.

³ In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Second Further Notice of Proposed Rulemaking, (released September 20, 1995) (Second FNPRM).

⁴ In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Fourth Further Notice of Proposed Rulemaking, (released September 27, 1995) (Fourth FNPRM).

efficiency gains, while enhancing the efficiency incentives of the plan and simplifying its administration.⁵

A few pages later, the Commission continues as follows:

[W]e tentatively conclude that the existing backstop mechanisms [sharing and low-end adjustment] should eventually be eliminated and we should move to a system of pure price caps. Further, we would like to explore alternatives to the use of sharing to create the proper incentives for LECs to select an X-Factor that corresponds to their actual, internal X-Factor.⁶

Further, in both of the other current FNPRMs released recently, the Commission is seeking to adopt a permanent price cap plan under which all carriers are free from sharing or any other constraints of rate-of-return (ROR) regulation. The following excerpts from the Fourth FNPRM describe the issues raised and questions asked by the Commission regarding this subject:

We are interested in determining whether there are other alternatives to the sharing mechanism that could be used to fashion a plan in which LECs have an incentive to choose an X-Factor that is appropriate for their economic circumstances. For example, would it be reasonable to permit additional pricing flexibility for carriers who elect a higher X-Factor?⁷

An alternative to sharing that could be used to match LECs with the X-Factor that is most appropriate for their economic circumstances is mandatory assignment of an X-Factor to each LEC.⁸

⁵ In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket 94-1, First Report and Order, 10 FCC Rcd 8961 ¶ 184 (1995).

⁶ Id. ¶ 197.

⁷ Fourth FNPRM, ¶ 118.

⁸ Id. ¶ 124.

One possible assignment mechanism would be to require LECs to use a higher X-Factor unless they can show that a lower one would be appropriate.⁹

If we adopt a moving average X-Factor and we determine that the "proper X-Factor choice" function of sharing can be replaced with either another incentive mechanism or by assignment of the X-Factor, we propose to eliminate sharing completely.¹⁰

As the above-quoted portions of the Fourth FNPRM clearly demonstrate, the Commission is currently examining whether and how sharing should be eliminated.

Proponents of cost allocation rules have been concerned about the ability of LECs to potentially affect the prices of the existing price cap regulated services due to the existence of the low-end adjustment. In the Fourth FNPRM, the Commission has asked whether the low-end adjustment mechanism should be eliminated.¹¹ The Commission had previously found that the low-end adjustment was fair and prudent for LECs experiencing low earnings in order to avoid protracted rate investigations and difficult above-cap filings and as a reasonable part of the sharing "backstop." However, the Fourth FNPRM makes the following request:

Parties are requested to comment on whether either of these concerns warrant retaining the low-end adjustment mechanism for those X-Factors for which sharing is required on a long-term basis, or whether the LECs' ability under our rules to file tariffs for rate increases is adequate to prevent confiscatory rates.¹²

⁹ Id. ¶ 125.

¹⁰ Id. ¶ 127.

¹¹ Fourth FNPRM, Issue 51 and ¶ 129.

¹² Fourth FNPRM, ¶ 129.

Thus, the Commission is considering elimination of the low-end adjustment mechanism as well.

Similarly, in the Second FNPRM, the Commission states as follows:

LEC price cap regulation is designed to promote economic efficiency by easing restrictions on overall profits while setting price ceilings at reasonable levels.¹³

While the current price cap plan gives LECs greater incentives to operate efficiently and greater flexibility in setting rates, compared to rate-of-return regulation, it still imposes significant regulatory constraints upon carriers. Such constraints tend to become unnecessary or counterproductive as market forces become operational.¹⁴

Growth in competition may also serve to reduce our need for a sharing mechanism if competitive pressures replicate some of the functions served by sharing.¹⁵

As each LEC faces increased competition for specific services, that competition will tend to force the prices towards cost. Eventually, the effect of this increased competition on prices may develop to a point such that it could replace the "flow-through" purpose of the sharing mechanism. Furthermore, it is possible that as LECs face more competition, their earnings will decrease, at least in the short run. If this is the case, then increases in competition at some point could replace the "backstop" purpose of the sharing mechanism.¹⁶

Under what circumstances could competition be used to replace the "flow-through" function of sharing?¹⁷

¹³ Second FNPRM, ¶ 18

¹⁴ Id. ¶ 21.

¹⁵ Id. ¶ 163.

¹⁶ Id. ¶ 164.

¹⁷ Id.

Also, and very importantly, the current versions of the proposed federal telecommunications legislation may require the eventual elimination of ROR regulation.¹⁸ This elimination would require the Commission to adopt a form of pure price cap regulation without sharing or a low-end adjustment for all LECs not subject to a small company exemption from the legislation.

Given the other places in which the Commission is seeking comment in this same docket and the direction being taken in the proposed federal legislation, the Commission should not presume in this phase of the docket that LECs will be subject to sharing and the low-end adjustment in the future. The basic premise that underlies the Third FNPRM does not appear to be correct. All of the price cap LECs may be subject to permanent "pure" price regulation in the near future. As such, there would be absolutely no need for the Third FNPRM's cost allocation scheme to remove VDT costs and revenues from the sharing and low-end adjustments that do not exist.

Thus, the Commission should not adopt the cost allocation proposals contained in the Third FNPRM. At a minimum, because the need for a *de minimis* threshold is based on the presumption that sharing and low-end adjustment are retained, the Commission's decisions in this Third FNPRM should await the outcome of the Second FNPRM and Fourth NPRM in this proceeding as well as the pending federal legislation, in which these fundamental aspects of regulation should be addressed.

¹⁸ H.R. 1555, 104th Cong. 1st Sess., Sec. 101, § 248 (1995); S. 652, 104th Cong., 1st Sess. Sec. 301 (1995).

II. AN APPROPRIATE INTERIM ALTERNATIVE WOULD BE TO USE THE EXISTING RULES FOR PRICE CAP EXCLUDED SERVICES.

If, contrary to the direction of the other initiatives, the Commission insists on applying existing price cap regulation to VDT and on excluding VDT costs and revenues from the sharing and low-end adjustment calculations,¹⁹ SWBT urges the Commission to consider a much less burdensome alternative to the Third FNPRM proposals on an interim basis until the Commission gains more experience with VDT costs, revenues and the video market performance and the other FNPRMs are finalized. During this brief interim period, any exclusion of VDT costs from sharing by those LECs electing a sharing option should be consistent with the existing rules for excluding costs of price cap excluded services for sharing calculations.²⁰ If the Commission adopts such a less burdensome alternative, the Third FNPRM's other proposals would be moot because the existing rules would suffice. Given that this interim period should be brief, it is not productive to create a new service-specific set of rules that would be superseded shortly after implementation. However, in the event the Commission rejects this proposal, SWBT provides input concerning the Third FNPRM's specific proposals in the remainder of its Comments.

¹⁹ SWBT argued against the exclusion of VDT costs in its Comments on the FNPRM in this proceeding. See Comments of Southwestern Bell Telephone Company, at 7-8 (April 17, 1995), filed in In the Matter of Price Cap Performance Review for Local Exchange Carriers: Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1, Further Notice of Proposed Rulemaking, 10 FCC Rcd 3141 (1995).

²⁰ The costs of price cap excluded services are assumed to be equal to revenues. See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313 ¶ 99; (released April 17, 1993); In the Matter of Commission Requirements for Cost Support Material To Be Filed with 1992 Annual Access Tariffs, DA 92-174, Order, ¶ 20 (released February 10, 1992).

III. THE *DE MINIMIS* THRESHOLD SHOULD NOT BE BASED ON RAO 25 DATA OR VDT INVESTMENT.

Subject to SWBT's objections to the Commission's price cap regulation of VDT service outlined above, SWBT continues by commenting on the proposed procedures for implementing such regulation. Due to the flaws in RAO 25, which are the subject of applications for review filed by LECs, including SWBT,²¹ SWBT does not believe it is proper to base the *de minimis* threshold on RAO 25 data. SWBT believes that the Bureau's unduly burdensome RAO 25 VDT and cost accounting requirements go beyond what is necessary to accomplish the purposes of the VDT Recon Order, and in doing so, create a service specific cost accounting system contrary to the intent of Part 32. The Commission should complete its review of RAO 25 consistent with its Rules, before using that data for such purposes. However, as explained in the next section, SWBT believes there is a simpler method of establishing the *de minimis* threshold which does not require the use of any video investment data.

In the Third NPRM, the Commission proposes to base the threshold on the amount of gross, dedicated VDT investment, that is, the total investment in Column (e) on the recently adopted VDT Quarterly Report (43-09A).²² SWBT does not believe that this would be an equitable mechanism for determining the *de minimis* threshold. First, because it focuses on the "wholly dedicated" amount of investment, the results could vary widely depending upon

²¹ Application for Review of Southwestern Bell Telephone Company, DA 95-1409 (May 3, 1995).

²² In the Matter of Reporting Requirements on Video Dialtone Costs and Jurisdictional Separations for Local Exchange Carriers Offering Video Dialtone Services, DA 95-2026, Appendix B, (released September 29, 1995) ("VDT Reporting Requirements"). The figure the Commission proposes to use would be the total VDT investment as identified in accounting records.

a particular LEC's VDT network architecture. That is, for example, those LECs whose chosen architecture has a proportionately larger amount of dedicated investment would reach the threshold sooner than a LEC who may have a comparable amount of overall VDT investment but whose architecture is different. Second, the use of this mechanism would involve a mismatch of gross and net figures, *i.e.*, the gross dedicated VDT investment versus the net investment data that represents the interstate rate base. The result of using net investment in the denominator is to overstate the portion of total investment represented by VDT. Third, rate of return calculations are not relevant criteria for evaluating individual price cap baskets or individual services. Fourth, SWBT believes that the proposed threshold is too low. Lastly, SWBT believes that there is a simpler, more equitable method, described in the next section, that avoids complex rate-of-return calculations based on the RAO 25 data.

Additionally, SWBT does not believe that trials should trigger the threshold. If trial costs are used in establishing the threshold, a LEC could be required to initiate a VDT price cap basket that would be unnecessary when the trial ends. Only when trials are converted to commercial offerings should the LEC initiate the VDT price cap basket, assuming it had reached the threshold.

IV. THE *DE MINIMIS* THRESHOLD SHOULD BE BASED ON A MATERIALITY STANDARD USING THE PERCENTAGE OF HOUSEHOLDS PASSED IN THE STUDY AREA.

In the Third FNPRM, the Commission "invite[s] parties to suggest alternate sources for the threshold data and different procedures for setting the threshold."²³ Assuming

²³ Third FNPRM, ¶ 42.

the Commission rejects the alternative to the Third FNPRM's proposals described in Section II above, SWBT suggests a method of determining a threshold which requires minimal data and uses a simple calculation based on the percentage of households passed by the VDT system(s) in the study area. Using a materiality standard similar to that which is used by public accounting firms in determining materiality for financial reporting purposes pursuant to GAAP, SWBT suggests that the threshold be set at five percent of total study area households passed by VDT facilities.²⁴ This threshold would be more consistent in determining when LECs must establish a VDT price cap basket in light of differing VDT system architectures. It also is a better indicator of the proportional size of a LEC's VDT system compared to its telephone system deployed in each study area. The calculation could be simply stated as the ratio of the number of households in the study area passed by the VDT system(s) compared to the LEC's total working loops in the study area. This method also avoids all of the problems enumerated above and the complexity inherent in using the Commission's proposed method based on dedicated VDT investment. Further, the data required is very limited and readily available through the VDT Quarterly Report (43-09A)²⁵ and the ARMIS 43-04 Report of Part 36 data.²⁶

²⁴ Number of households passed is one of the items of information that the Commission is requiring in the VDT Quarterly Report. See VDT Reporting Requirements, ¶ 41.

²⁵ Id.

²⁶ In the Matter of Revisions of ARMIS Report 43-04 (The Access Report), 6 FCC Rcd 1008, Appendix 2, at 15 line 1270 (1991).

V. VDT COSTS SHOULD BE ALLOCATED TO THE VDT BASKET BY DIRECT ASSIGNMENT OF THE PART 36 INTERSTATE VDT COSTS.

The Commission also seeks comments on the method for allocating VDT costs to the VDT basket once the *de minimis* threshold is reached. The Commission suggests two possible alternatives, 1) a cost allocation based on the approach taken in the new services test (perhaps differing based on the specific VDT architecture employed); or 2) a fixed allocation factor. SWBT does not support either of these alternatives.

Once the previously discussed threshold level has been reached, the simplest approach would be to directly assign to the VDT basket the interstate VDT cost determined by the use of existing Part 32 and Part 36 rules. Specifically, current Part 32 rules will identify the dedicated VDT costs while current Part 36 rules will identify the appropriate allocation of joint VDT/telephony costs as well as VDT "overhead" allocations. When combined, the resulting data captures the total amount of regulated interstate VDT costs that may be directly assigned to the rate elements to be established pursuant to the Part 69 waivers required by the Commission.²⁷

The Commission's suggestion that a new fixed cost allocation factor be developed to assign costs to the new VDT basket is unnecessary since the actual separated VDT costs are available. Further, the Commission's suggestion that the costs assigned to the VDT basket be based on the approach used in the new services test is inconsistent with how costs are determined for all other services. Part 69 fully distributed costs are no longer used in Part 61, on a service-

²⁷ Telephone Company - Cable Television Cross-Ownership Rules, Sections 63.54-63.58 and Amendments of Parts 32, 36, 61, 64 and 69 of the Commission's Rules to Establish and Implement Regulatory Procedures for Video Dialtone Service, CC Docket No. 87-266, 10 FCC Rcd 244 ¶¶ 196-97 (1994) (VDT Recon Order).

by-service or price cap Service Category basis, for the determination of appropriate rates, nor should they be.

VI. CONCLUSION

Subject to SWBT's objections to the application of price cap regulation to a competitive video service, SWBT respectfully requests that the Commission adopt the recommendations set forth herein.

Respectfully submitted,

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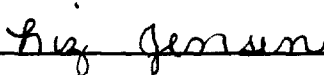
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CERTIFICATE OF SERVICE

I, Liz Jensen, hereby certify that the foregoing
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